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**MARYLAND TAKEOVER LEGISLATION**

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MARYLAND STATE BAR ASSOCIATION

SECTION ON CORPORATION BANKING AND BUSINESS LAW

Special Committee on Corporate Acquisitions

Summary of Provisions of Proposed Bills to  
Modify Maryland Takeover Law

At the request of Chairman Horne, the Maryland State Bar Association Special Committee on Corporate Acquisitions (the "Special Committee") has submitted for consideration by the Judiciary Committee two proposed bills that contain, in separated form, essentially the same substantive provisions as those contained in H.B. 1321, introduced in the 1988 Session. One of the bills, referred to herein as the "Moratorium Bill," is attached hereto as Appendix A. The other bill, referred to herein as the "Control Share Bill," is attached hereto as Appendix B.

Set forth below is a section-by-section description of the principal provisions of the Moratorium Bill and the Control Share Bill.

A. THE MORATORIUM BILL

The Moratorium Bill would modify Maryland's existing Fair Price Statute (§§ 3-601 through 3-603 of the Corporations and Associations Article). The proposed modifications are largely based upon the Special Committee's review and consideration of modifications that have been made by other states in their enactment or amendment of fair price statutes that were based upon Maryland's original model.

References in the following summary are to sections and page numbers in Appendix A.

1. § 3-601(e)(6) on page 7 expands the definition of "business combination" to include instances in which an interested stockholder receives a benefit from the corporation in the form of any loan, advance, guarantee, pledge, or other financial assistance, tax credit or tax advantage. These benefits constitute ways in which an interested stockholder could, in effect, use the assets of a target corporation, even though the stockholder is prohibited from carrying out a freezeout merger or other second step transaction.

2. § 3-602(a) on page 10 establishes the "moratorium" prohibition against "business combinations" between the corporation and an interested stockholder for five years after the most recent date on which the interested stockholder became an interested stockholder.



3. § 3-602(a)(2) on page 11 modifies the definition of "determination date" to reflect the fact that a stockholder could move in and out of the status of being an "interested stockholder."

4. § 3-603(b) on pages 12 through 17 is amended to add an interest factor to the fair price formula. The interest factor is necessary because the imposition of a moratorium could result in a five-year wait until the "fair price" is paid in a later business combination. In addition, the referenced periods for determining a price under the fair price formulas have been modified to reflect the possible five-year waiting period prior to the occurrence of a business combination.

5. In § 3-603(c)(1) on pages 19 and 20, the addition of the clause "in whole or in part" makes it clear that a Board action to opt out of § 3-602 may be tailored to opt out of only a part of that Section.

6. § 3-603(e)(1)(iii) on page 22 permits a charter amendment opt-out from the provisions of § 3-602. The proposed amendment to this subsection would (a) permit the charter amendment to be tailored to opt out of only a part of that Section, (b) provide that a minimum 18-month moratorium would apply even after the adoption of a charter amendment opting out of the general five-year moratorium provision, and (c) provide that a charter amendment opt-out would not apply to any specific business combination if the vote on the amendment occurs after the interested stockholder involved in that combination became an interested stockholder.

7. § 3-603(e)(1)(v) on page 23 would exempt from the statute a stockholder who inadvertently crosses the 10% threshold to become an interested stockholder and promptly divests himself of a sufficient number of shares to go below the threshold.

8. § 3-604 on page 24 is added to make it clear that the statute applies only to Maryland chartered corporations.

#### B. THE CONTROL SHARE BILL

The Control Share Bill is based on the Indiana Control Share Statute approved by the United States Supreme Court in the CTS case, with modifications made by the Special Committee after a review of modifications included in control share statutes adopted by numerous other states.

References in the following summary are to sections and page numbers in Appendix B.

1. § 3-701(d) on pages 3 and 4 generally defines "control shares" as those which are in excess of the one-fifth, one-



third, or one-half threshold as a percentage of total outstanding voting power, and as to which a stockholder vote approving voting rights has not previously been obtained.

2. § 3-702 on pages 6 through 8 provides that, with certain exceptions, control shares acquired in a control share acquisition have no voting rights except such rights as are approved by a two-thirds vote of disinterested stockholders.

3. § 3-701(e) on pages 4 through 6 defines "control share acquisition" as the direct or indirect acquisition of issued and outstanding control shares or of the power to direct the exercise of voting power with respect to control shares. This provision also sets forth an exception for certain share acquisitions, including those made before January 11, 1989, acquisitions by inheritance, and acquisitions in good faith from any person whose voting rights were previously approved under this subtitle.

4. § 3-702(b) on page 7 permits general or specific opt-outs from the subtitle by charter or bylaw provisions that exist prior to an acquisition of control shares.

5. § 3-702(c) on page 7 exempts from the subtitle close corporations, corporations with fewer than 100 beneficial owners, and investment companies.

6. § 3-703 and § 3-704 on pages 8 through 10 permit the acquiror of control shares to submit an information statement concerning an acquisition or proposed acquisition of shares and to call for a special meeting of stockholders to approve voting power for the control shares. The information statement must include a representation that the acquiring person has specific adequate financing for any proposed acquisition of shares. § 3-705 on pages 10 and 11 provides that the corporation need not call a special meeting unless the acquiring person presents definitive, executed financing agreements for any financing required in addition to the acquiring person's own resources.

7. § 3-706 on pages 11 and 12 requires the corporation to give notice of a stockholders meeting requested by an acquiring person and to deliver copies of the acquiring person's statement and a statement setting forth any position or recommendation of the Board.

8. § 3-707 on pages 12 and 13 provides that, under certain circumstances, the corporation is permitted, at its option, to redeem any or all of the control shares held by an acquiring person. The redemption price is to be at "fair value" without taking into account any reduction in value reflecting the lack of voting rights.

9. § 3-708 on pages 13 and 14 provides that if the stockholders approve the voting rights of control shares and the





acquiring person holds majority voting power, the remaining stockholders will have the right to sell their shares to the corporation at fair value determined under statutory appraisal provisions.

10. § 3-709 on page 14 provides that the subtitle will apply only to Maryland chartered corporations.

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MARYLAND STATE BAR ASSOCIATION

SECTION OF BUSINESS LAW

Special Committee on Corporate Acquisitions

Background on Takeover Legislation  
prepared for  
Senate Judicial Proceedings Committee

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I. TYPICAL TAKEOVER SCENARIO

- A. Raider acquires 4.9% without public disclosure.  
(Williams Act requires public disclosure of acquisitions of more than 5%.)
- B. Raider then goes over 5%, files Williams Act disclosure (Schedule 13D) and announces tender offer for enough shares to give raider control.
- C. Raider acquires enough shares in tender offer ("first step") to gain control.
- D. Using its control position, raider generally either (1) merges the target into a 100%-owned subsidiary ("second step"), forcing out non-tendering stockholders, often at a lower price, or (2) busts up company in a liquidation.

II. "FIRST GENERATION" TAKEOVER LEGISLATION

- A. Typical "first generation" statute (37 states):  
registration, waiting period, hearing if requested by target board.



B. Edgar v. MITE Corp. (June 1982) - Supreme Court held Illinois "first generation" takeover statute unconstitutional on ground it was indirect burden on interstate commerce.

C. Bendix v. Martin Marietta (Sept. 1982) - U.S. District Court for Maryland held Maryland "first generation" statute unconstitutional under MITE.

### III. TYPES OF CURRENT "SECOND GENERATION" (POST-MITE) TAKEOVER LEGISLATION (See Appendix A)

A. Common elements to principal "second generation" takeover statutes:

1. Avoid regulating the "first step" (tender offer) because of possible pre-exemption by Williams Act under Supremacy Clause;
2. Create an incentive to raider to either
  - a. negotiate with board of directors as agent for all the stockholders or
  - b. offer a high, all-cash offer for 100% of shares.

B. Fair Price Statutes:

1. Typically require any merger or other business combination between a corporation and an "interested shareholder" (owner of more than 10% of voting stock) to be approved by two supermajority votes (80% of all shares and 2/3 of shares not owned by the interested stockholder) unless:



- a. interested stockholder pays all other stockholders a "fair price" for their shares and meets certain other conditions,
    - b. Board opts out of statute before raider becomes interested stockholder, or
    - c. certain other limited exceptions.
  2. Any dissenting stockholders in the supermajority votes are entitled to cash in the amount of the "fair price."
  3. First enacted in Maryland in 1983 -- Corps. & Ass'ns Article, §§ 3-601 et seq.
- C. Control Share Statutes:
1. Typically require filing of an acquiring person statement, call of stockholders' meeting and approval by disinterested stockholders of voting rights for any shares acquired in excess of three (20%, 33%, 50%) thresholds.
  2. Right to redeem control shares at fair value if acquiring person does not file acquiring person statement.
  3. Dissenters' rights if voting rights are approved for control shares.
  4. Exceptions
    - a. Target agrees.
    - b. Charter opt-out.
    - c. Issuance of shares by target.





5. Only type of takeover statute specifically approved by Supreme Court. Dynamics Corp. v. CTS Corp. (1987).

D. Moratorium (business combination) statutes:

1. Typically prohibit any merger or other business combination between a corporation and an interested stockholder for five years unless Board approves combination before raider becomes an interested stockholder.
2. Exceptions
  - a. Charter amendment opt-out.
  - b. Inadvertent interested stockholder.
3. Usually enacted in tandem with or as an addition to a fair price statute.
4. Generally viewed as most effective legislation in deterring abusive takeovers.
5. Upheld by two federal courts in Delaware.

IV. NEED FOR ADDITIONAL LEGISLATION IN MARYLAND

- A. Fair price statute is not sufficient protection.
  1. Offers no protection against "bust-up" takeovers.
  2. Never upheld as to constitutionality.
  3. Contains exception for charter amendments without requiring payment of superappraisal rights.



4. Only reason raider would opt for fair price exception would be if it thought it could not win supermajority votes; most likely reason for a raider's thinking it could not win these votes would be that its price is too low.

B. Many Maryland-chartered corporations would benefit from legislation, including many with headquarters and other facilities located in Maryland (see Appendix B).

C. More than 30 states have enacted some form of takeover legislation (see Appendix A), including

1. 32 states which have enacted statutes other than fair price statutes;
2. 28 states which have enacted legislation in the 15 months since the CTS decision; and
3. 20 states which have both a fair price statute and either a control share or moratorium statute and 9 states which have all three.

D. Act before an emergency, e.g., Washington (Boeing), Arizona (Greyhound), Minnesota (Dayton Hudson), North Carolina (Burlington).

E. Encourage raiders to negotiate with target's board of directors, thereby enhancing the likelihood of a higher price for all stockholders.

#### V. ARGUMENTS AGAINST TAKEOVER LEGISLATION

A. Interferes with national free market.

Response: Let Congress worry about the national



free market. Does anyone think Pennsylvania or Virginia were worrying about the national market when they passed takeover legislation recently? They were worried about Pennsylvania and Virginia corporations and local jobs.

B. Prevents takeovers.

Response: Totally wrong. A 1984 study showed that between 1976 and 1984 there were nearly 1,800 acquisitions of publicly traded companies, of which over 90% were non-hostile, negotiated transactions. Statistics since 1984 are substantially similar.

C. Entrenches management.

Response:

1. Boards of directors remove poor managers all the time.
2. There are many more effective ways (e.g., long-term employment contracts) for a manager to entrench himself than takeover legislation.

D. Prevents stockholders from maximizing value.

Response: A recent study by Georgeson & Company showed that prices received in takeovers of companies with poison pills averaged 69% higher than prices received by stockholders in takeovers of companies without poison pills. A poison pill, like a takeover statute, is simply another means of getting the raider to negotiate with the Board of



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Directors. Two recent studies of takeover statutes in Ohio and New Jersey by researchers at Northeastern University have found that the statutes had no adverse impact on the stock prices or stockholder values of corporations chartered in these states.





## PRE- AND POST-CTS TAKEOVER STATUTES

Prepared by James J. Hanks, Jr.  
and Stephen Stec  
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Baltimore, Maryland  
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STATE	FAIR PRICE	MORATORIUM	CONTROL SHARE	CASH OUT	REGISTRATION/ DISCLOSURE	OTHER CONSTITU- ENCIES	OTHER
ALABAMA							
ALASKA							
ARIZONA	Y*	Y*	Y*			Y*	2*, 7*
ARKANSAS							
CALIFORNIA							9*
COLORADO							
CONNECTICUT	X	Y					
DELAWARE		Y					
FLORIDA	Y		Y				
GEORGIA	X	Y					
HAWAII			X		X		6
IDAHIO	Y	Y	Y		X, Y	Y	
ILLINOIS	X					X	
INDIANA	X*	X*	X*			X	
IOWA							



PRE- AND POST-CTS TAKEOVER STATUTES

STATE	FAIR PRICE	MORATORIUM	CONTROL SHARE	CASH OUT	REGISTRATION/ DISCLOSURE	OTHER CONSTITU- ENCIES	OTHER
KANSAS			Y				
KENTUCKY	X	X					6
LOUISIANA	X		Y			Y	
MAINE		Y*		X		X	
MARYLAND	X*	P	P				
MASSACHUSETTS			Y*				5
MICHIGAN	(X)		Y				
MINNESOTA	Y*	Y*	(X), Y*		X		3, 7*
MISSISSIPPI	X						
MISSOURI	X	X	(X), Y		X	X*	
MONTANA							
NEBRASKA		Y	Y		X, Y	Y	8
NEVADA			Y				
NEW HAMPSHIRE			Y		Y		
NEW JERSEY	X	X					
NEW MEXICO						Y*	
NEW YORK	X*	X*			X	Y	



PRE- AND POST-CTS TAKEOVER STATUTES

<u>STATE</u>	<u>FAIR PRICE</u>	<u>MORATORIUM</u>	<u>CONTROL SHARE</u>	<u>CASH OUT</u>	<u>REGISTRATION/ DISCLOSURE</u>	<u>OTHER CONSTITUENCIES</u>	<u>OTHER</u>
<u>NORTH CAROLINA</u>	Y		Y				
<u>NORTH DAKOTA</u>							
<u>OHIO</u>			X			X	4
<u>OKLAHOMA</u>			Y*				
<u>OREGON</u>			Y*				
<u>PENNSYLVANIA</u>	Y	Y		X, Y	X, Y	X	6
<u>RHODE ISLAND</u>							
<u>SOUTH CAROLINA</u>	Y	Y	Y		Y		
<u>SOUTH DAKOTA</u>							
<u>TENNESSEE</u>	Y	Y	Y		X		
<u>TEXAS</u>							
<u>UTAH</u>			Y*	(X)	X		
<u>VERMONT</u>							
<u>VIRGINIA</u>	X	Y					
<u>WASHINGTON</u>	X	Y*					
<u>WEST VIRGINIA</u>							
<u>WISCONSIN</u>	X	Y*	(X)			Y	1



PRE- AND POST-CTS TAKEOVER STATUTES

STATE	FAIR PRICE	MORATORIUM	CONTROL SHARE	CASH OUT	REGISTRATION/ DISCLOSURE	OTHER	
						CONSTITU- ENCIES	OTHER

WYOMING

X	=	Enacted pre-CTS					
Y	=	Enacted post-CTS					
P	=	Proposed					
(	=	Repealed					
1	=	"Scaled-voting" statute					
2	=	"Anti-greenmail" statute					
3	=	Delayed effective date of "anti-greenmail" statute					
4	=	Case challenging validity of statute pending (reargued 12/10/87)					
5	=	Foreign corporation "opt-in"					
6	=	Poison pill validation statute					
7	=	"Anti-chutes" statute					
8	=	Voting rights unimpaired with regard to election of directors					
9	=	Fairness opinion/late-proposal notice statute					
*	=	Enacted as emergency legislation or during special session					





APPENDIX B

PARTIAL LIST OF MAJOR MARYLAND-CHARTERED PUBLICLY-HELD CORPORATIONS

Headquartered in Maryland

Alex. Brown Inc.  
Baltimore Bancorp  
The Black & Decker Corporation  
Classic Corporation  
Crown Central Petroleum Corporation  
E.I.L. Instruments Inc.  
Easco Hand Tools, Inc.  
Equitable Bancorporation  
First Maryland Bancorp  
Legg Mason, Inc.  
MNC Financial, Inc.  
Martin Marietta Corporation  
McCormick & Company Incorporated  
Mercantile Bankshares Corporation  
Noxell Corporation  
PHH Group, Inc.  
PharmaKinetics Laboratories, Inc.  
Polk Audio, Inc.  
Preston Trucking Company, Inc.  
The Rouse Company  
USF&G Corporation  
Waverly Corporation

Headquartered Outside Maryland

Alexander & Alexander Services Inc.  
Inspiration Resources Corporation  
Louisiana Land and Exploration Company  
The McDonnell Douglas Corporation  
Revere Copper and Brass Incorporated  
Sara Lee Corporation

